paulin

Annual Report 2002 • H.Paulin & Co., Limited

paulin® Merchandised Products:

Legend

1 Eye to Eye Turnbuckle
2 Knock Down Furniture Cam Receptacle and Screw
3 Floor Screw
4 Plastic Wall Anchor
5 Plastic Shelf Support with Steel Pin
6 External Thread Wheel Nut
7 Picture Hanging Wire
8 Aluminum Round Tubing
9 Slotted Steel Angle
10 Coded Bolt Nut Washer
11 Wire Rope Clip
12 Twist Nail
13 Double Door Magnetic Latch
14 Wine Cork
15 'Duradized' Coated Deck Screws
16 Pocket Hole/Face Frame Screws
17 Masonry Drill Bit
18 Glass Door Latch Plate

Company Profile

- H. Paulin & Co., Limited was founded in 1920 by Harry Paulin.
- The Company is a leading manufacturer and distributor of fasteners, fluid system products, automotive parts and screw machine components.
- Manufacturing processes include Cold Heading, Nut Forming, Metal Stamping, Screw Machine, Adhesive Coating and Packaging.
- All divisions are ISO 9002 registered and in addition Capital Metal Industries, Jeyco Machine Products and Long-Lok Canada are QS 9000 certified.
- Typical industries served are automotive, both OEM and aftermarket, industrial, retail hardware and agricultural.
- Distribution facilities are located in Vancouver, Edmonton, Winnipeg, Toronto, Montreal, Moncton and Cleveland, Ohio.
- All manufacturing facilities are located in Ontario, Canada.
- Paulin is a public company and its common shares are listed and traded on The Toronto Stock Exchange under the symbol PAP.A.

Company Products are sold under such trademarks as:

papco®	Automotive Aftermarket Products	pro•tip®	Screwdriver and Bits
Dominion®	Fluid Flow Components	FASTENER FINDER™	Computer Touch Screen
WORK-SAVERS®	Do-It-Yourself Hardware	Contractor Quality paulin®	Contractor Quality
pic-a-pac®	Packaged Fasteners	Easy-Spot®	Weld Fasteners

Table of Contents

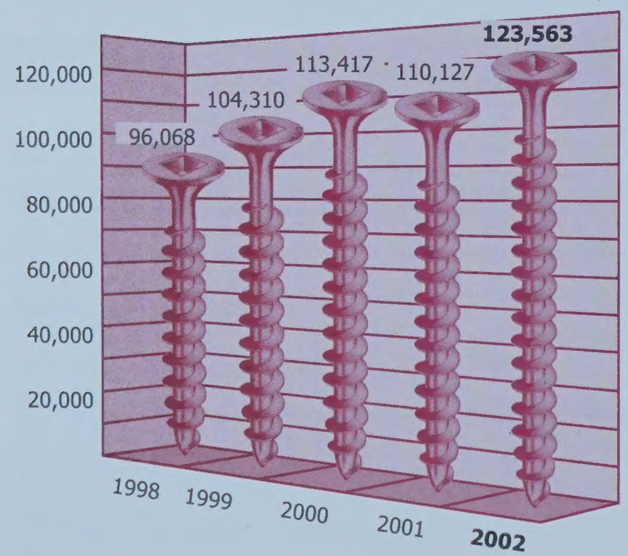
Financial Highlights

(in thousands of dollars, except per share amounts)

Results	2002	2001
Sales	**$ 123,563**	$ 110,127
EBITDA (1)	**$ 9,004**	$ 8,243
Net Income	**$ 3,215**	$ 3,204
Dividends	**$ 452**	$ 420
Working Capital	**$ 24,461**	$ 26,216
Total Assets	**$ 83,528**	$ 63,227
Shareholders' Equity	**$ 35,242**	$ 32,479
Cash Flow from Operations	**$ 5,905**	$ 4,994
Per Share Data (2)		
EBITDA (1)	**$ 8.58**	$ 7.85
Net Income	**$ 3.06**	$ 3.05
Dividends	**$ 0.43**	$ 0.40
Shareholders' Equity	**$ 33.56**	$ 30.93
Cash Flow from Operations	**$ 5.62**	$ 4.76
Ratios		
Return on average equity	**9.5%**	10.3%
Current ratio	**1.6**	2.1
Debt to equity	**80.6%**	47.0%

(1) Earnings before interest, taxes, depreciation and amortization
(2) Based on 1,050,000 shares outstanding

Annual Sales $ (000's)



Earnings per Share

Message to Shareholders

We are pleased to submit our Consolidated Financial Report for the year ended December 31, 2002. Our annual sales reached a record level of $123.6 million, representing an increase of 12% over the $110.1 million in 2001. Net income climbed marginally to $3.22 million or $3.06 per share as compared to $3.2 million or $3.05 per share in the previous year. Dividends were raised to $0.43 per share from $0.40 per share in 2001.

The past year was satisfying in terms of our overall performance. The Company embarked on a number of initiatives which should provide for stable long-term growth. During the second half of the year the Company installed its hardware fastener program into nearly 50 Home Depot stores in the United States. While our initial set-up costs negatively impacted the 2002 results, we do expect to see profitable contributions from this business in the future.

Our strategy of investing in new technologies continued, with the second highest capital expenditures in our history. Over $5.4 million of production machinery, material handling equipment and merchandising fixtures were acquired. These investments will enhance our production capabilities, increase capacity, improve product quality and strengthen our overall cost structure.

In 2003 we face a number of issues including unstable steel markets, customer consolidations and the ever-increasing customer demands for price concessions and higher quality and service levels. In response to these challenges, our actions will include:

- further diversification of our customer base
- development of more sophisticated, complex parts yielding higher margins
- enhancing our operational performance with improved manufacturing processes, innovative technologies and stricter financial controls
- additional training and education for our employees

All of our team have demonstrated the dedication and drive necessary to reach our goals. Our investment in personnel includes our commitment to providing a safe, healthy environment, free of harassment and discrimination. This past year we hired a Health and Safety Coordinator to ensure our commitment to the well being of all of our staff.

We have established a solid foundation from which we can face the challenges of the future and continue to expand our business in the long term. We would like to express our appreciation to our employees, customers, suppliers and shareholders for their support and for contributing to our success. We would also like to thank our Board members for their experience, commitment, diligence and guidance.

Richard Paulin

Richard Paulin
President
May 2, 2003

Management's Discussion and Analysis

The Company classifies its businesses into two distinct segments – Manufacturing and Distribution.

These two segments service three major markets:

1. Automotive (original equipment and aftermarket)
2. Industrial (distributor and original equipment)
3. Do-It-Yourself Hardware (wholesalers and Big Box stores)

Sales to the automotive market increased as a result of both increased market share and the improvement in North American light vehicle production volumes. Total North American vehicle production for 2002 was 16.3 million units, representing an increase of 5% from the 15.5 million vehicles built in 2001. Despite this growth, margins were adversely affected by competitive market conditions, higher quality demands and a number of new product launches.

Although the industrial market showed some improvement over 2001, the office furniture and telecommunication equipment industries remained very weak. The Do-It-Yourself hardware market enjoyed solid growth as a result of a strong housing market and consumers' desires to invest in their homes.

Results of Operations

For the year ended December 31, 2002 sales totaled $123.6 million, up 12% or $13.4 million over the previous year and up 9% over 2000. Every division in the Company achieved sales increases. Significant areas of growth were in sales to the retail hardware market and to the automotive Tier 1 and Tier 2 suppliers. Export sales climbed 40% to represent 10% of total sales, up from 8% in 2001 as the Company expanded its sales in the United States.

Income from operations before selling, general and administrative expenses increased 13% or $3.1 million to $25.9 million from $22.9 million in 2001 and was up 7% over 2000. Gross margins for the current year were 21.0% as compared to 20.8% in 2001 and 21.4% in 2000. Current gross margins were positively affected by the higher sales volumes and better product mix but were adversely affected by downward pressure on prices, rising raw material prices and higher utility and labour costs.

Selling and administrative expenses climbed 16% or $2.3 million over 2001 and 10% over 2000. Significant increases in the number of service personnel involved in the expansion of our retail hardware sales in Canada and the United States contributed to the increase in selling expenses. Higher delivery charges and expenses related to information technology investments were also factors.

Earnings before interest, taxes, depreciation and amortization (EBITDA) climbed to $9.0 million, an increase of 10% over 2001 and 1% over 2000. A reconciliation of EBITDA to net income is as follows:

	2002	2001	2000
EBITDA	**$ 9.0 million**	$ 8.2 million	$ 8.9 million
Interest	**1.2**	1.2	1.0
Taxes	**2.2**	2.0	2.5
Depreciation & amortization	**2.4**	1.8	1.4
NET INCOME	**$ 3.2 million**	$ 3.2 million	$ 4.0 million

Results of Operations (cont'd)

The Company believes that, in addition to cash flow from operations and net income, EBITDA (which is not a measure recognized under Canadian generally accepted accounting principles) is a useful financial performance measure for assessing operating performance as it provides an additional basis to evaluate the ability of the Company to incur and service debt and to fund capital expenditures. The Company notes, however, that EBITDA should not be construed as an alternative to net income (loss) or cash flow from operations determined in accordance with GAAP as an indicator of its performance, and that the Company's method of calculating EBITDA may differ from that used by other companies.

Interest expense declined 3% to $1.16 million from $1.19 million the previous year. Declining interest rates offset the increase in the average loan outstanding during 2002. Interest expense is expected to increase in 2003 due to recently announced increases in the prime lending rate, the new capital lease entered into late in 2002 and a generally higher level of bank indebtedness needed to manage the increased volume of business.

Depreciation expense was up 33% or $595,000 to $2.4 million as compared to $1.8 million in 2001 and $1.4 million in 2000. This increase reflected the investment of over $5.4 million in 2002 in capital expenditures and over $16 million over the last five years. Investments in capital expenditures included new production machinery, material handling equipment and merchandising fixtures.

The effective income tax rate was 41%, up from 39% in 2001 and 38% in 2000. The reduction in the federal tax rate was offset by reductions in the manufacturing and processing allowance, an increase in our large corporation tax and the zero rate adjustment for 2002.

Net income amounted to $3.22 million as compared to $3.2 million in 2001 and $4.0 million in 2000. Earnings per share were $3.06 versus $3.05 in 2001 and $3.79 in 2000.

Cash Flow

Cash flow from operating activities (before net changes in non-cash working capital balances related to operations) rose 18% to $5.9 million from $5.0 million in 2001 and $5.6 million in 2000. Operating cash flow per share was $5.62 as compared to $4.76 in 2001 and $5.36 in 2000.

Cash flow was reduced by $13.2 million as a result of a net increase in the non-cash components of working capital. Accounts receivable increased $4.5 million from 2001 as a result of increased sales and extended payment terms to certain customers.

Inventories grew $10.4 million to $43.2 million from $32.8 million in 2001 and $31.9 million in 2000. A number of factors contributed to the increase in inventories. The sales expansion into the United States required a major investment in inventory by our U.S. subsidiary company, Paulin Industries Inc.. In order to support expected sales in 2003, inventories in all divisions of the Company were increased to provide the ever-increasing service levels demanded by our customers. The addition of over 1,100 new products and higher material costs all contributed to the inventory increase.

Accounts payable increased by $4.3 million to $17.8 million from $13.5 million in 2001 and $14.5 million in 2000.

Income taxes recoverable were $1.8 million, an increase of $2.1 million over the tax payable of $0.3 million in 2001. The net figure of $1.8 million includes the $2.4 million deposit paid to the Canada Customs and Revenue Agency (CCRA) resulting from the re-assessment received in the first quarter of 2002. As the Company believes it has reported its tax position appropriately, a Notice of Objection has been filed.

Financial Position

Working capital was $24.5 million, down from $26.2 million in 2001 and $25.9 million in 2000. Current ratio declined to 1.6:1 from 2.1:1 and 2.0:1 from the previous two years. Since $4.9 million of long-term debt comes due in 2003 it is considered current and has adversely affected the working capital and working capital ratio in 2002.

Capital expenditures totaled $5.4 million in 2002 as compared to $3.5 million in 2001 and $3.2 million in 2000. These expenditures related primarily to the acquisition of production equipment for the cold forming and screw machine operations, material handling equipment and merchandising fixtures for the U.S. market expansion. In December of 2002, $3.6 million of equipment was sold to the Bank of Nova Scotia and leased back for a five-year term at 5.35%.

Cash dividends paid to shareholders were $452,000 or $0.43 per share as compared to $420,000 or $0.40 per share in 2001 and $462,000 or $0.44 per share in 2000.

Payments of $350,000 were made towards long-term debt in 2002 as compared to $352,000 in 2001 and $350,000 in 2000. In 2003, it is the Company's intention to re-finance $5 million of current long-term debt with other long-term debt instruments.

Bank indebtedness increased $10.0 million to $19.4 million from $9.4 million in 2001 and $9.6 million in 2000. The major factors contributing to this increase were the $10.4 million increase in inventory and the $2.4 million deposit paid to CCRA.

As a result of the increase in bank indebtedness, the debt to equity ratio increased to 0.81:1 from 0.47:1 in 2001 and 0.53:1 in 2000. Current banking operating lines are adequate and the Company does not hold or issue financial instruments for trading purposes.

Shareholders' equity increased by 9% or $2.8 million to $35.2 million in 2002 from $32.5 million at the end of the previous year. Return on average equity declined to 9.5% from 10.3% in 2001 and 14.2% in 2000.

The long-term debt to equity ratio stood at 9% at year-end as compared to 15% in 2001 and 19% in 2000.

The book value rose to $33.56 per share, up 9% over $30.93 in 2001 and 19% from $28.28 in 2000.

Risks and Uncertainties

The markets in which Paulin operates are highly competitive. Competitors range in size from large, multi-national corporations to relatively small, regional companies. Some of these competitors may have greater financial and other resources than the Company.

An economic slowdown would have a negative impact on results. Since approximately 68% of the Company's debt is at floating rates and the debt is significantly higher than in 2001, an exposure to interest rate fluctuations exists. The Company also purchases many of its products worldwide and, therefore, can be affected by currency fluctuations. Export sales are also affected by currency fluctuation.

Manufacturing

The Company has a number of operations specializing in the following manufacturing processes:

- Cold Heading and Nut Forming
- Precision Turned Products
- Metal Stamping
- Processing and Coatings
- Packaging

All manufacturing operations experienced a number of common elements in 2002. Sales volumes improved throughout the year with each operation achieving record sales. Margins, however, were adversely impacted by the worldwide rising cost of steel created as a result of trade actions taken by the United States in March of 2002. In addition, the automotive industry's constant and increasing demand for price concessions coupled with the growing costs associated with zero defect quality levels further impacted margins. Increased competition from global manufacturers created further pressure on the manufacturing operations. All of our facilities have taken actions to try to convert these threats into competitive advantages.

These include:

- Capital Investment – New machinery was installed to help lower production costs, manufacture niche products with better margins, improve quality and reduce maintenance costs.
- Engineering and Design – Working to re-engineer fastening applications to provide lower cost alternatives for the customer by changing methods of manufacturing.
- Quality Improvement – Investments in custom vision and laser inspection equipment to reduce sorting costs and provide zero defect parts.
- Continuous Improvement – New systems and better processes are evaluated and implemented in order to reduce costs, improve profits and offset customer pricing demands.

Cold Heading and Nut Forming

The cold forming operations manufacture bolts, screws, nuts, spacers, special fasteners and screwdriver bits primarily from steel, brass, silicon bronze and stainless steel.

In order to expand the product range offered, new parts forming, threading, tapping and secondary operation equipment was installed. New, innovative tool design was utilized to convert more expensive screw machine parts into lower cost cold-formed products. New vision and laser sorting equipment was acquired to improve and expand inspection capabilities. A new production planning system was installed late in the year, which will provide improved machine utilization, enhance productivity and raise service levels.

Precision Turned Products

Precision turned products are manufactured from bar stock on multi-spindle, rotary transfer and CNC (Computer Numeric Control) machines. Parts are manufactured from steel, brass, aluminum, stainless steel and nylon.

Despite a small increase in revenues, profits declined in this operation as it prepared for the launch of a number of new programs in 2003 and from the competitive pressures on margins. In order to further differentiate its product line, four additional rotary transfer machines were installed in 2002. These machines will allow us to efficiently manufacture high quality niche products. As a preferred supplier to a number of Tier one and Tier two automotive suppliers, this operation expects to improve performance in 2003.

Metal Stamping

The stamping division produces our line of Easy Spot® weld nuts, leg levelers, washers, automotive shims and custom specials.

The stamping operation was adversely affected by the significant increase in steel costs and the continued slowdown in the furniture and communication industries. New tapping and feeding equipment was installed, improving productivity and quality. The addition of new products should help sales growth in 2003.

Processing and Coating

This operation applies locking and sealing compounds to threaded fasteners to prevent loosening and to allow ease of assembly. Major processes include the insertion of a nylon strip or the application of a micro-encapsulated adhesive or sealant to external or internal threads in order to make the fastener or fitting self-locking or self-sealing.

Sales and profits reached record levels in 2002. Demand for self-locking and self-sealing fasteners continued to grow in automotive, recreational and furniture industries as new applications using these features were engineered. In particular, the application of thread sealants to the bearing surface of bolts has provided engineers with the opportunity to increase loading torques to beyond their normal capacity without compromising bolt integrity.

The division will move to larger facilities in the first quarter of 2003, providing it with the space necessary to expand operations.

Packaging

The packaging operation converts fasteners from bulk into a variety of smaller packaged quantities. In-house facilities include skin packaging, blister cards, clamshells, bagging, kits, boxing and specialty head marking.

Continued growth of packaged goods sales in Canada, coupled with the expansion in the U.S. increased demand on the Company's packaging facilities throughout the year.

In order to satisfy these requirements, new bagging, labeling and coding equipment was added. The introduction of a newly developed, semi-automatic packaging workstation in the latter part of the year to improve packaging efficiency proved successful. Additional automation is planned for 2003.

Distribution

The distribution division merchandises and distributes a complete line of over 75,000 SKU's (stock keeping units) of fasteners and fittings to the hardware, industrial and automotive aftermarket from a network of distribution centers across Canada and the United States.

The product supplied is purchased from a network of vendors around the world. As a result of the unstable worldwide steel market, many of the products incurred cost increases and experienced delivery interruptions during the last half of 2002 and into 2003.

Significantly higher inventory levels were maintained in order to ensure 100% service levels and to support the new hardware business in the United States.

Higher labour costs in 2002 were incurred to support the change in product mix to increased packaged product and to provide Vendor Managed Inventory (VMI) for the retail and industrial markets. Freight costs increased, reflecting higher rates and more frequent deliveries. Efforts to reduce some of these costs have been initiated and should help our future performance.

Hardware

The highlight for 2002 for the hardware business was the successful introduction of Paulin fasteners into 46 Home Depot stores in the Illinois market. The conversion of these stores occurred during the second and third quarters and involved the removal of existing fixtures, the installation of new merchandising fixtures as well as installation of the *Fastener Finder™* and over 2,400 different fasteners. In addition, the Company was successful in being chosen as the fastener supplier for Home Depot's new urban store concept, which opened two stores in the United States in 2002.

The introduction of over 800 new SKU's, including such products as hooks, eyes and turnbuckles, helped to strengthen sales and provide our customers with a single vendor for more product lines.

New innovative merchandising methods, the development of superior hand-held technology to manage inventories and a trained, dedicated service team will provide continued growth for 2003.

Industrial

Sales to industrial OEM's (Original Equipment Manufacturers) and distributors grew in 2002 as a result of increased market share. Excellent service and good regional inventories provided stable growth with the industrial distributors. A strengthened sales force operating with new, electronic capabilities helped stimulate new business. The expansion of the Vendor Managed Inventory (VMI) programs with selected accounts resulted in a strong value added service for the customers, creating both new business and additional opportunities for 2003. The addition of new product lines, new merchandising and new catalogues for 2003 should stimulate additional growth.

Automotive Aftermarket

The Canadian automotive aftermarket experienced virtually no growth in 2002. Our aftermarket sales remained stable as some market share gains and growth in the heavy-duty market were offset by inventory rationalization and private branding by some of our customers. For 2003, efforts to expand into new markets will be undertaken and new merchandising and products will be added to the program to stimulate sales.

Fluid Flow Components

The fittings division manufactures airbrake and hose assemblies and distributes a complete line of over 9,700 steel and brass fittings, valves, tubing, hose and tube working tools. Major markets served by this division include propane, plumbing, hardware, industrial and the automotive aftermarket.

Sales for 2002 increased as a result of the development of new customer business and selling more product lines to existing customers. New products introduced included oil tank valves, delivery hose and coated copper tubing. The fittings division had its certification to ISO upgraded to the new ISO 9001:2000 standard.

For 2003, the introduction of a new catalogue, a number of new product lines and a strengthened sales force should improve performance.

Outlook

The generally sluggish North American economy is adversely affecting demand and selling prices. The Canadian market has started to show signs of slowing down and the recent increase in interest rates and strengthening Canadian dollar could further inhibit growth.

The automotive industry anticipates a softening in vehicle sales volume for 2003 after a 2% gain in the first quarter of this year. We have already seen some cutbacks in releases for the second quarter.

With the housing market forecasted to produce similar numbers in 2003 as in 2002, we anticipate continued growth from this sector as consumers devote increased dollars to house renovations.

New capital expenditures will be made to reduce logistical costs, strengthen manufacturing capabilities and provide better information systems. We are cautiously optimistic that 2003 will show improved performance over last year.

CERTAIN STATEMENTS IN THE REPORT ARE "FORWARD-LOOKING STATEMENTS" WHICH REFLECT MANAGEMENT'S EXPECTATIONS REGARDING PAULIN'S FUTURE GROWTH, RESULTS OF OPERATIONS, PERFORMANCE AND BUSINESS PROSPECTS AND OPPORTUNITIES. SUCH FORWARD LOOKING STATEMENTS REFLECT MANAGEMENT'S CURRENT BELIEFS AND ARE BASED ON INFORMATION CURRENTLY AVAILABLE TO MANAGEMENT. FORWARD LOOKING STATEMENTS INVOLVE SIGNIFICANT RISKS AND UNCERTAINTIES. A NUMBER OF FACTORS COULD CAUSE ACTUAL RESULTS TO DIFFER MATERIALLY FROM THE RESULT DISCUSSED IN THE FORWARD LOOKING STATEMENTS INCLUDING RISKS ASSOCIATED WITH VULNERABILITY TO ECONOMIC CONDITIONS, COMPETITION, REGULATORY CHANGE, FOREIGN EXCHANGE, INTEREST RATES, RELIANCE ON KEY PERSONNEL, UNINSURED AND UNDERINSURED LOSSES AND RESTRICTIONS ON POTENTIAL GROWTH. ALTHOUGH THE FORWARD LOOKING STATEMENTS CONTAINED IN THIS REPORT ARE BASED UPON WHAT MANAGEMENT BELIEVES TO BE REASONABLE ASSUMPTIONS, PAULIN CANNOT ASSURE INVESTORS THAT ACTUAL RESULTS WILL BE CONSISTENT WITH THESE FORWARD LOOKING STATEMENTS. THESE FORWARD LOOKING STATEMENTS ARE MADE AS OF THE DATE OF THIS REPORT, AND PAULIN ASSUMES NO OBLIGATION TO UPDATE OR REVISE THEM TO REFLECT NEW EVENTS OR CIRCUMSTANCES.

Auditors' Report

To the Shareholders of
H. Paulin & Co., Limited

We have audited the consolidated balance sheets of H. Paulin & Co., Limited as at December 31, 2002 and 2001 and the consolidated statements of operations and retained earnings and of cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2002 and 2001 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP
Chartered Accountants

Toronto, Ontario
March 28, 2003

H.Paulin & Co., Limited and its wholly owned subsidiaries

Consolidated Balance Sheets

as at December 31 (in thousands of dollars) (Incorporated under the Laws of Ontario)

	2002	2001
ASSETS		
CURRENT		
Accounts receivable	**$ 21,366**	$ 16,903
Income taxes recoverable	**1,794**	–
Inventories	**43,152**	32,760
Sundry assets and prepaid expenses	**1,111**	537
	67,423	50,200
CAPITAL ASSETS (Note 3)	**16,105**	13,027
	$ 83,528	$ 63,227
LIABILITIES		
CURRENT		
Bank indebtedness (Note 4)	**$ 19,436**	$ 9,450
Accounts payable and accrued charges	**17,748**	13,480
Income taxes payable	**–**	266
Current portion of long-term debt (Note 5)	**5,778**	788
	42,962	23,984
LONG-TERM DEBT (Note 5)	**3,197**	4,942
FUTURE INCOME TAXES	**2,127**	1,822
	48,286	30,748
SHAREHOLDERS' EQUITY		
SHARE CAPITAL (Note 6)	**1,016**	1,016
RETAINED EARNINGS	**34,226**	31,463
	35,242	32,479
	$ 83,528	$ 63,227

APPROVED BY THE BOARD

Richard Paulin
Director

Stanley F. Paulin
Director

H.Paulin & Co., Limited and its wholly owned subsidiaries

Consolidated Statements of Operations and Retained Earnings

for the years ended December 31 (in thousands of dollars, except per share amounts)

	2002	2001
SALES	**$ 123,563**	$ 110,127
INCOME FROM OPERATIONS BEFORE THE FOLLOWING CHARGES	**$ 25,935**	$ 22,871
Selling, general and administrative expenses	**16,931**	14,628
Depreciation and amortization	**2,385**	1,790
Interest, including interest on long-term debt of $ 374 (2001 - $396)	**1,158**	1,192
	20,474	17,610
INCOME BEFORE INCOME TAXES	**5,461**	5,261
INCOME TAXES (Note 7)	**2,246**	2,057
NET INCOME FOR THE YEAR	**3,215**	3,204
RETAINED EARNINGS, BEGINNING OF YEAR	**31,463**	28,679
DIVIDENDS	**(452)**	(420)
RETAINED EARNINGS, END OF YEAR	**$ 34,226**	$ 31,463
PER SHARE INFORMATION (Note 6)		
Income per share	**$ 3.06**	$ 3.05
Diluted income per share	**$ 3.05**	$ 3.05
Dividends per share	**$ 0.43**	$ 0.40

Consolidated Statements of Cash Flows

for the years ended December 31 (in thousands of dollars, except per share amounts)

	2002	2001
NET INFLOW (OUTFLOW) OF CASH RELATED TO THE FOLLOWING ACTIVITIES		
OPERATING		
Net income for the year	**$ 3,215**	$ 3,204
Items not affecting cash		
Depreciation and amortization	**2,385**	1,790
Future income taxes	**305**	–
	5,905	4,994
Changes in non-cash components of working capital		
Accounts receivable	**(4,463)**	1,423
Income taxes recoverable/payable	**(2,060)**	(346)
Inventories	**(10,392)**	(843)
Sundry assets and prepaid expenses	**(574)**	252
Accounts payable and accrued charges	**4,268**	(1,007)
	(7,316)	4,473
FINANCING		
Dividends paid	**(452)**	(420)
Change in bank indebtedness	**9,986**	(193)
Increase in long-term debt	**3,595**	–
Repayment of long-term debt	**(350)**	(352)
	12,779	(965)
INVESTING		
Purchase of capital assets	**(5,463)**	(3,508)
NET CASH INFLOW	**–**	–
CASH, BEGINNING OF YEAR	**–**	–
CASH, END OF YEAR	**$ –**	$ –
SUPPLEMENTARY CASH FLOWS INFORMATION		
Interest paid	**$ 1,144**	$ 1,192
Income taxes paid	**$ 4,185**	$ 2,748

Notes to the Consolidated Financial Statements

December 31, 2002 and 2001 (in thousands of dollars, except per share amounts)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and include the following significant accounting policies:

a) Consolidation

The consolidated financial statements include the accounts of H. Paulin & Co., Limited and its wholly-owned subsidiary companies.

b) Inventories

Inventories are valued at the lower of cost and net realizable value, with cost being determined on a first-in, first-out basis.

c) Capital assets

Capital assets are recorded at cost. Provision for depreciation and amortization is computed using annual rates and methods which will depreciate the assets over their estimated useful lives as follows:

Building	-	4%, declining-balance
Merchandising fixtures	-	33%, straight-line
Machinery and equipment	-	10%, straight-line
Furniture, office equipment	-	20-33%, straight-line or declining-balance
Leasehold improvements	-	term of lease, straight-line

d) Income taxes

The Company uses the liability method of income tax allocation. Under this method, future income tax assets and liabilities are determined based on the differences between the financial accounting and tax bases of assets and liabilities, and are measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse.

e) Foreign currencies

The Company's foreign subsidiary is considered financially and operationally interdependent. Translation into Canadian dollars of the foreign subsidiary's accounts and translation of other foreign currency denominated transactions is as follows:

- Monetary items at the rate of exchange at the balance sheet date.
- Non-monetary items at the historical exchange rates.
- Transactions occurring during the year at the then-prevailing rates.
- Gains or losses on foreign exchange are included in income in the year incurred.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

f) Stock option plan

The Company has an employee stock option plan, which is described in Note 6. The Company adopted the new accounting standards for stock-based compensation and other stock-based payments (see Note 2). As allowed by the standard, the Company has elected to continue to account for the employee stock-based compensation plans using the intrinsic value-based method.

g) Use of estimates

In preparing the Company's financial statements, management is required to make estimates and assumptions that affect the reported amount of assets, liabilities, and the disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

2. CHANGES IN ACCOUNTING POLICIES

Earnings per share

Effective for 2001, the Company adopted the treasury stock method for calculation of diluted earnings per share under which deemed proceeds of the exercise of options are considered to be used to re-acquire common shares at an average share price. Previously, additional earnings were imputed based on the proceeds resulting from the exercise of options. The Company adopted this calculation retroactively with restatement of the prior year.

Stock-based compensation

The Company has an employee stock option plan, which is described in Note 6.

Effective January 1, 2002, the Company adopted the Canadian Institute of Chartered Accountants ("CICA") recommendations in Handbook Section 3870 "Stock-based Compensation and Other Stock-based Payments" ("HB 3870"). These guidelines establish standards for the recognition, measurement and disclosure of stock-based compensation and other stock-based payments made in exchange for goods and services. HB 3870 sets out a fair value based method of accounting that is required for certain, but not for all, stock-based transactions.

The new standard permits the Company to continue its existing policy that no compensation cost is recorded on the grant of stock options to employees. Consideration paid by employees on the exercise of stock options is recorded as share capital.

HB 3870, however, does require additional disclosures for options granted to employees, including disclosure of pro forma earnings and pro forma earnings per share as if the fair value based accounting method had been used to account for employee stock options. The adoption of HB 3870 did not have an effect on the Company's results of operations or financial condition.

3. CAPITAL ASSETS

	2002			2001		
	Cost	**Accumulated Depreciation**	**Net Book Value**	Cost	Accumulated Depreciation	Net Book Value
Land	**$ 730**	**$ –**	**$ 730**	$ 730	$ –	$ 730
Building	**601**	**184**	**417**	601	167	434
Merchandising fixtures	**1,030**	**196**	**834**	–	–	–
Machinery and equipment	**27,911**	**15,249**	**12,662**	24,390	13,956	10,434
Furniture, office equipment and leasehold improvements	**5,373**	**3,911**	**1,462**	4,864	3,435	1,429
	$35,645	**$ 19,540**	**$16,105**	$ 30,585	$ 17,558	$13,027

Included in machinery and equipment at December 31, 2002 are assets under capital lease in the amount of $3,595,000 (2001 - $nil), with no related accumulated depreciation.

4. BANK INDEBTEDNESS

The Company has a $30 million (2001 - $25 million) operating facility with a Canadian chartered bank bearing interest at the bank's prime lending rate. This facility, which is unsecured and due on demand, requires the Company to meet certain general conditions prescribed by the bank. The facility was increased to $35 million subsequent to the year-end.

The Company has a $4 million long-term borrowing from this facility at a fixed interest rate of 6.6% per annum (see Note 5). While this long-term borrowing remains a demand loan, demand prior to maturity is not contemplated.

In December, 2002, the Company used $3,595,000 of an available $5 million revolving loan credit facility to assist in the financing of machinery and equipment. This credit facility bears interest at 5.35% per annum; is secured by the machinery and equipment financed, and is guaranteed by a subsidiary of the Company.

5. LONG-TERM DEBT

Details of the Company's long-term bank borrowings are as follows:

	2002	2001
6.6% per annum, interest only, unsecured, maturing June 10, 2003	**$ 4,000**	$ 4,000
5.35% per annum, capital lease secured by specific equipment, maturing December 31, 2007	**3,595**	–
6.9% per annum, unsecured, maturing August 27, 2003	**942**	1,030
5.05% per annum, secured by specific equipment, maturing August 23, 2004	**438**	700
	8,975	5,730
Less current portion	**5,778**	788
	$ 3,197	$ 4,942

5. LONG-TERM DEBT (continued)

Future minimum principal payments on long-term debt and on the obligations under the capital lease are as follows:

	Long-term Debt	Capital lease
2003	$ 5,778	$ 750
2004	719	692
2005	573	692
2006	605	692
2007	1,300	1,354
	$ 8,975	4,180
Less imputed interest at 5.35%		585
		3,595
Less current portion		573
		$ 3,022

6. SHARE CAPITAL

Authorized

2,000,000 Class A Common Shares

2,000 Common Shares

	2002	2001
Issued and outstanding		
1,050,000 Class A Common Shares (2001 - 1,050,000)	**$ 1,016**	$ 1,016

Stock option plan

In 1998, an employee stock option plan was created for the issuance of a maximum of 105,000 Class A Common Shares.

The options vest evenly over a 3 year period and expire 10 years from the grant date.

A summary of the status of the Company's options to purchase Class A Common Shares as of December 31, 2002 and 2001 and changes during the years then ended is presented below:

	Share Options	Weighted Average Exercise Price
Outstanding, as at January 1, 2001 and December 31, 2001	43,500	$ 20.25
Granted	2,500	20.25
Exercised	–	–
Expired	–	–
Outstanding as at December 31, 2002	46,000	$ 20.25
Options exercisable as at December 31, 2001 and 2002	43,500	$ 20.25

6. SHARE CAPITAL (continued)

The following table summarizes information about the stock options outstanding at December 31, 2002 and 2001:

	2002	2001
Exercise price	**$ 20.25**	$ 20.25
Number of options outstanding	**46,000**	43,500
Weighted average remaining contractual life in years	**5.69**	6.50
Weighted average exercise price	**$ 20.25**	$ 20.25

Income and diluted income per share

Income and diluted income per share are calculated using net income of $3,215,000 (2001 - $3,204,000) and the weighted average number of Class A Common shares outstanding of 1,050,000 in each year. The denominator in the calculation of diluted income per share was 1,053,659 (2001 – 1,050,000) under the assumption that all outstanding stock options were exercised.

Generally accepted accounting principles require the disclosure of pro forma net income as if the Company had accounted for its stock options issued subsequent to December 31, 2001 under the fair value method. The Company has evaluated the fair value of the options granted during the year using the Black-Scholes option pricing model to estimate the fair value of the options at the date of the grant. The Company determined that the fair values are insignificant and do not have an effect on its results of operations, or income per share. The financial statements, therefore, do not include the pro forma disclosure.

7. INCOME TAXES

The reconciliation of the provision for income taxes reflected in the financial statements with the amount of tax that would result from the application of Canadian statutory tax rates to reported income, is as follows:

	2002	2001
Income before income taxes	**$ 5,461**	$ 5,261
Approximate applicable statutory tax rate	**39 %**	42%
Income taxes at statutory tax rates	**2,130**	2,210
Add (deduct) the tax effect of		
Manufacturing and processing allowance	**(160)**	(210)
Large corporations tax	**50**	30
Rate adjustment	**–**	(230)
Other	**226**	257
	$ 2,246	$ 2,057

7. INCOME TAXES (continued)

On February 28, 2002, the Company received a notice of reassessment from the Canada Customs and Revenue Agency ("CCRA") for adjustments to the Company's corporate tax returns for the 1997 and 1998 taxation years. The reassessment in the amount of approximately $1,700,000 plus interest for those years primarily reflects CCRA's opinion that the Company claimed excessive provisions for slow moving or obsolete inventory. In 2002, deposits of $2.4 million covering interest and taxes were paid.

The Company believes it has reported its tax position appropriately and has filed a Notice of Objection with the CCRA. Substantially all of the income taxes arising, should the appeal be unsuccessful, will be recovered in 1999 and future taxation years due to the reversing nature of the proposed adjustments. Although the eventual outcome of this issue cannot be determined at this time, the Company's accounts provide for management's best estimate of any potential exposure.

8. LEASE OBLIGATIONS

The Company leases property, plant and equipment under agreements which are classified as operating leases. The aggregate minimum annual rental payments under these leases are as follows:

2003	$	3,262
2004		3,189
2005		2,026
2006		1,355
2007		1,205
Thereafter		798
	$	11,835

9. RELATED PARTY TRANSACTIONS

The Company leases plants in Scarborough and Milton from its principal shareholders and officers. The lease payments to these related parties were approximately $730,000 in 2002 (2001 - $723,000). These payments were determined based on market rates and the commitments are included in Note 8.

10. POST-EMPLOYMENT BENEFIT COSTS

During 2001, the Company implemented a defined contribution post employment benefit plan (the "Plan") for its employees. The assets of the Plan are held separately from those of the Company in an independently administered fund. Contributions expensed by the Company for the year ended December 31, 2002 amounted to $319,000 (2001 - $130,000).

11. SEGMENTED INFORMATION

The Company operates principally in Canada in two business segments. The Manufacturing segment produces, assembles and packages fasteners, fittings and parts mainly for automotive Tier 1 and Tier 2 suppliers, industrial OEMs, hardware and industrial distributors. The Distribution segment merchandises and distributes ferrous and non-ferrous fasteners and fittings to the hardware, automotive aftermarket and industrial markets.

The following is a breakdown of the two segments' financial information:

	2002	2001
Sales		
Manufacturing	**$ 102,700**	$ 89,800
Distribution	**35,400**	30,100
Intersegment	**(14,500)**	(9,800)
Total	**$ 123,600**	$ 110,100
Income before income taxes		
Manufacturing	**$ 4,700**	$ 4,600
Distribution	**800**	700
Total	**$ 5,500**	$ 5,300
Depreciation and amortization		
Manufacturing	**$ 1,800**	$ 1,400
Distribution	**600**	400
Total	**$ 2,400**	$ 1,800
Net capital expenditures		
Manufacturing	**$ 500**	$ 3,200
Distribution	**1,400**	300
Total	**$ 1,900**	$ 3,500
Capital assets (NBV)		
Manufacturing	**$ 12,400**	$ 10,400
Distribution	**3,700**	2,600
Total	**$ 16,100**	$ 13,000

Export sales account for approximately 10% (2001 - 8%) of sales to external customers.

12. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Fair value of financial assets and liabilities

Following are the major methods and assumptions used in estimating the fair value of financial instruments:

i) The fair value of current assets and liabilities approximate their carrying amounts due to the relatively short maturity period of the instruments.

ii) The fair value of long-term debt is calculated based on the present value of expected cash flows using rates currently available to the Company for long-term debt with similar terms and remaining maturities. The fair value of long-term debt is estimated at $9.0 million (2001 - $5.7 million).

Concentration of credit risks

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist principally of accounts receivable. Concentrations of credit risk with respect to these receivables are limited as the Company conducts regular assessments of credit issues. As at December 31, 2002, one customer accounted for 26% of accounts receivable (2001 – no customer accounted for more than 10%).

Interest rate risk

The Company's primary interest rate exposure is on its bank indebtedness with a chartered bank, which bears interest at floating rates.

Foreign currency risk

The Company's foreign currency exposure arises from purchase and sale contracts transacted in U.S. dollars. During 2002, an aggregate foreign exchange loss of approximately $60,000 was recorded in the statement of operations.

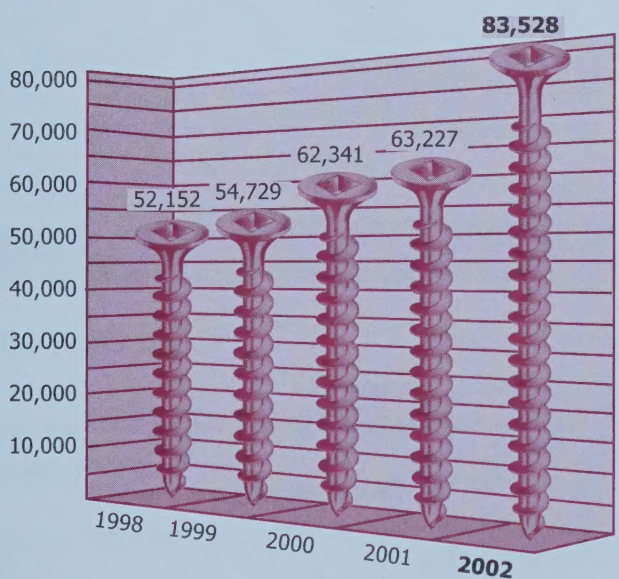
Ten year statistical summary

Years ending December 31, 1993-2002

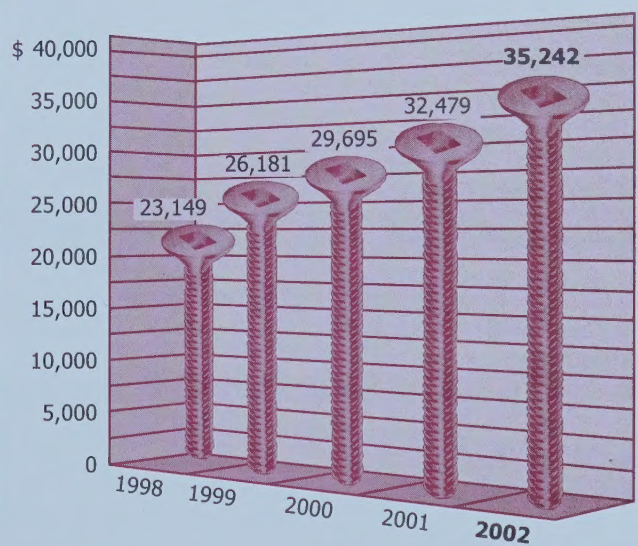
Dollars in thousands except as indicated †	1993	1994	1995	1996	1997	1998	1999	2000	2001	**2002**
Sales	50,399	64,485	70,031	74,018	87,612	96,068	104,310	113,417	110,127	**123,563**
Depreciation and Amortization	627	663	662	676	1,042	1,129	1,459	1,427	1,790	**2,385**
Income Taxes	215	799	917	1,003	1,475	2,240	2,413	2,471	2,057	**2,246**
Net Income	310	1,166	1,228	1,329	2,008	2,970	3,452	3,976	3,204	**3,215**
Income per Share*†	0.30	1.11	1.17	1.27	1.91	2.83	3.29	3.79	3.05	**3.06**
Net Income % of Sales	0.6	1.8	1.8	1.8	2.3	3.1	3.3	3.5	2.9	**2.6**
Additions to Fixed Assets	491	2,285	821	2,900	2,137	2,389	1,982	3,188	3,508	**5,463**
Working Capital	13,913	14,415	15,444	14,252	16,523	21,847	24,316	25,939	26,216	**24,461**
Shareholders' Equity	15,666	16,685	17,724	18,802	20,537	23,149	26,181	29,695	32,479	**35,242**
Average Return on Equity %	2.0	7.2	7.1	7.3	10.2	13.6	14.0	14.2	10.3	**9.5**
Dividends per Share * †	0.05	0.14	0.18	0.24	0.26	0.34	0.40	0.44	0.40	**0.43**

* Based on 1,050,000 shares outstanding as at December 31, 2002

Total Assets $ (000's)



Shareholders' Equity $ (000's)



H. Paulin & Co., Limited

BOARD OF DIRECTORS

Dr. Irving Betcherman, Toronto
Corporate Director

Arnold B. Irwin, Toronto
Corporate Director

Stanley F. Paulin, Toronto
Vice-President, H.Paulin & Co., Limited

Vincent P. Reid, Q.C. Collingwood
Corporate Director

Harvey G. Kotler, Q.C. Toronto
Solicitor, Kotler Law Firm

Richard C. Paulin, Toronto
President, H.Paulin & Co., Limited

OFFICERS

Richard C. Paulin
President

Stanley F. Paulin
Vice-President, Secretary

Jeffrey Jonsohn
Vice-President, Operations

Carl Krause
Treasurer

AUDIT COMMITTEE

Dr. Irving Betcherman
Richard C. Paulin
Vincent P. Reid

HUMAN RESOURCE AND CORPORATE GOVERNANCE COMMITTEE

Harvey G. Kotler
Richard C. Paulin
Vincent P. Reid

HEAD OFFICE
55 Milne Avenue
Toronto, Ontario M1L 4N3
Tel.: (416) 694-3351
Fax: (416) 694-1869
E-mail: paulin@hpaulin.com

Investor Relations (416) 694-3360 ext.135

AUDITORS
Deloitte & Touche LLP, Toronto

LEGAL COUNSEL
Goodmans LLP, Toronto

STOCK TRADING SYMBOL
PAP.A on the Toronto Stock Exchange

REGISTRAR AND TRANSFER AGENT
Computershare Trust Company of Canada

BANK
Bank of Nova Scotia, Toronto

ANNUAL MEETING
The Annual Meeting of Shareholders
will be held at
The Inn on the Park, Oak Room
1100 Eglinton Avenue East
Toronto, Ontario
Thursday, June 19, 2003
11:00 a.m. (E.S.T.)

paulin® Custom Manufactured Products:

Legend

Cold Formed	Precision Turned	Process Coated – Adhesive/Sealant
1 Steering Column Sleeve Chrysler - Pacifica	**5** Seat Back Recliner Spring Post Honda - Pilot/Acura MDX	**9** Engine Block Heater Fitting GM - Vortec
2 Engine Cradle Sleeve Chrysler	**6** Fuel Door Hinge GM	**10** A/C Hose Connector Ford - Triton
3 Weld Spacer Chrysler Minivan	**7** Seat Back Recliner Shaft GM - Malibu	**11** Flange Bolt Ford
4 Projection Weld Fastener	**8** Seat Disk Recliner Shaft Chrysler - Pacifica	**12** Brass Threaded Frost Plug GM - Vortec